

May 15, 2008

Barbara A. Schermerhorn
ClerkNOT FOR PUBLICATIONUNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT

IN RE RED ROCK RIG 101, LTD.,
Debtor.

BAP No. WO-07-073

RED ROCK RIG 101, LTD.,
Appellant,Bankr. No. 07-10477
Chapter 7

v.

ORDER AND JUDGMENT*

UNIBRIDGE SYSTEMS, INC.,
NORTHWEST SERVICE AND
EQUIPMENT COMPANY,
COMSTOCK OILFIELD SUPPLY,
INC., WOODROW WILSON, doing
business as Inspection International,
KENNETH RUSSELL, NORTHWEST
BEARING AND SUPPLY, INC.,
BOOMER MUD PUMP AND SUPPLY,
GAINESVILLE FUEL, INC., R5 CAPS
& TEES, T3 STRING-UP, L.L.C., THI
WIREROPE, L.L.C., TRI-STATE
MACHINE & SUPPLY, WOODWARD
REGIONAL HOSPITAL, ZEE
MEDICAL SERVICES, SUSAN J.
MANCHESTER, Trustee,

Appellees.

Appeal from the United States Bankruptcy Court
for the Western District of Oklahoma

Before NUGENT, McNIFF, and THURMAN, Bankruptcy Judges.

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP L.R. 8018-6(a).

McNIFF, Bankruptcy Judge.

Red Rock Rig 101, Ltd. (Rig 101) appeals the bankruptcy court's order for relief under Chapter 7 pursuant to 11 U.S.C. § 303. We affirm.

Background

Rig 101 was formed as a limited partnership for the purpose of providing a rig to be used for drilling oil and gas wells. Red Rock Drilling, Inc. is the general partner of Rig 101. Additionally, Red Rock Drilling, Inc. formed Red Rock Rig 102, Ltd. for the same purpose as Rig 101. Red Rock Energy is also a principal in the organizational tier of these companies and all have some of the same investors.

Rig 101 entered into a contract with Unibridge Systems, Inc. ("Unibridge"), on or about March 15, 2006, to manufacture the rig. *See Agreement, in Appendix of Appellant ("Appx.") Vol. 2 at 624.* Disputes evolved between the parties, whereas Rig 101 alleged that Unibridge agreed to manufacture the rig in approximately four months for the sum of \$3.5 million, and thereafter and at different times, Unibridge requested more funds and failed to meet modified delivery deadlines. The events cumulated to the point that on February 2, 2007, Rig 101 filed an action in the United States District Court for the Western District of Oklahoma ("District Court") for prejudgment replevin of the rig and/or an injunction against Unibridge to maintain the status quo with regard to the rig. Unibridge denied all allegations. The District Court initially entered a temporary restraining order and on March 27, 2007, entered a preliminary injunction to maintain the status quo to insure that Rig 101 was not dismantled, mortgaged or sold during the pendency of further proceedings. The District Court did not grant the requested replevin on behalf of Rig 101. *See Order, in Appx. Vol. 3 at 647.*

During that same time period, on February 23, 2007, Unibridge, Northwest Service and Equipment Co., Comstock Oilfield Supply, Inc., Woodrow Wilson d/b/a Inspection International, and the Daniluk Corporation, filed an involuntary

Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Western District of Oklahoma naming Rig 101 as the Debtor. *See Involuntary Petition, in Appx. Vol. 1 at 21.* Subsequently, Northwest Bearing Inc., Schwab's Tinker Shop, Inc., and Kenneth Russell applied to join as petitioning creditors. *See Applications of Schwab's Tinker Shop, Inc., Kenneth Russell, and Northwest Bearing, Inc. to Join as Petitioning Creditors, in Appx. Vol. 1 at 35, 37, and 39, respectively.* The Order Granting Applications to Join as Petitioning Creditors was entered April 30, 2007. Appx. Vol. 1 at 41. Just prior to the hearing on Rig 101's objection to the commencement of the involuntary petition, Boomer Mud Pump & Supply, Gainesville Fuel, Inc., R5 Caps & Tees, T3 String-Up, L.L.C., THI Wirerope, L.L.C., Tri-State Machine and Supply, Woodward Regional Hospital, and Zee Medical Services joined as petitioning creditors. *See Application to Join Additional Petitioning Creditors, in Appx. Vol. 1 at 45.* The Daniluk Corporation and Schwab's Tinker Shop, Inc. subsequently withdrew.

Rig 101 objected to the involuntary petition and a hearing was held on May 1st, 2nd and 15th, 2007. The bankruptcy court reconvened on May 23, 2007 to announce its findings of facts and enter its order concluding that the involuntary Chapter 7 bankruptcy was properly commenced. Rig 101 timely appealed.

Jurisdiction

The Bankruptcy Appellate Panel has jurisdiction to hear appeals from final judgments within this circuit. 28 U.S.C. § 158(a)(1) & (b)(1). The parties have not chosen to have this appeal heard by the United States District Court for the Western District of Oklahoma; therefore, they are deemed to have consented to jurisdiction of the Bankruptcy Appellate Panel. 28 U.S.C. § 158(c)(1)(A) & (B); Fed. R. Bankr. P. 8001(e).

Standard of Review

The Bankruptcy Appellate Panel may

affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree on remand with instructions for further proceedings. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the bankruptcy court to judge the credibility of the witnesses.

Fed. R. Bankr. P. 8013. The Court reviews the bankruptcy court's decision under the same standard used by the bankruptcy court and affirms when the court's factual findings are not clearly erroneous. *In re Burkart Farm and Livestock*, 938 F.2d 1114, 1115 (10th Cir. 1991). A factual finding is clearly erroneous, when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed. *Hall v. Vance*, 887 F.2d 1041, 1043 (10th Cir. 1989). We must accept the bankruptcy court's determination unless "that determination either (1) is completely devoid of minimum evidentiary support displaying some hue of credibility, or (2) bears no rational relationship to supportive evidentiary data." *In re Mama D'Angelo, Inc.*, F.3d 552, 555 (10th Cir. 1995) (quoting *Krasnov v. Dinan*, 465 F.2d 1298, 1302 (3rd Cir. 1972)). We determine that the proper standard of review in this appeal is the clearly erroneous standard.

Discussion

An involuntary Chapter 7 bankruptcy may be commenced: (1) against a person that may be a debtor under the Chapter under which the case is commenced; (2) if that debtor has more than 12 creditors, three creditors must join in the involuntary petition; (3) the creditors bringing the involuntary petition must have claims not subject to a bona fide dispute as to liability or amount; and, (4) have aggregate claims in the amount of more than \$12,300. 11 U.S.C. § 303(b).

The court determines a bona fide dispute exists if there is an objective basis for either a factual or legal dispute as to the validity of the debt. *Bartmann v. Maverick Tube Corp.*, 853 F.2d 1540, 1543-44 (10th Cir. 1988). The Court does

not have to determine the probable outcome of the dispute, but merely that one exists. *Bartmann* at 1544. The debtor's intent does not control whether a claim is considered to be subject to a bona fide dispute. *Id.* at 1544. Once a petitioning creditor establishes a prima facie case that its claim is not subject to a bona fide dispute as to liability or amount, the burden then shifts to the Debtor to present evidence of a bona fide dispute. *Id.* The mere existence of pending litigation is insufficient to establish the existence of a bona fide dispute. *In re Vortex Fishing Sys., Inc.*, 277 F.3d 1057, 1066 (9th Cir. 2003). However, the pendency of litigation suggests that a bona fide dispute exists. *In re BDC 56 LLC*, 330 F.3d 111 (2nd Cir. 2003).

Additionally, the court must determine if the debtor was paying its debts as they became due to determine if the involuntary bankruptcy was properly commenced. 11 U.S.C. §303(h)(1). The court looks to the date that the involuntary petition was filed to make this determination. *In re Harmsen*, 320 B.R. 188 (10th Cir. BAP 2005). The burden of demonstrating that the debtor is not paying its debts is on the petitioning creditors. If the petitioning creditors meet the burden then the burden shifts to the debtor to show that the debts are subject to a bona fide dispute. *Harmsen* at 197. The Tenth Circuit concluded that the bankruptcy court should examine the totality of the circumstances, balancing the interests of the debtor with those of the creditors, using a flexible case-by-case approach allowing the bankruptcy court, as the trial court, to receive and consider all admissible evidence presented, the demeanor and creditability of the witnesses, and the argument of counsel to make its determination whether the creditor has met its burden. *Bartmann*, 853 F.2d at 1546. Payments of debtor's obligations by a third party are not treated as payment by the debtor itself. *In re Food Gallery at Valleybrook*, 222 B.R. 480, 488 (Bankr. W.D. Pa. 1998) (citing *In re Knoth*, 168 B.R. 311, 317 (Bankr. D. S.C. 1994) and *H.I.J.P. Props. Denver*, 115 B.R. 275, 277 (D. Colo 1990). Additional cash infusions from third party

payments is not evidence that a debtor was paying its debts as they become due. *Food Gallery* at 489. A company whose payments of its debts with borrowed funds which creates another liability is generally not paying its debts as they come due. *In re Midwest Processing Co.*, 41 B.R. 90, 101, (Bankr. D. N.D. 1994), *rev'd on other grounds*, 47 B.R. 903 (D. N.D. 1984), *aff'd*, 769 F.2d 483 (8th Cir. 1985).

The first consideration in determining if an involuntary petition is properly commenced is to determine if the person may be a debtor in the bankruptcy case. A debtor is a “person . . . concerning which a case under this title has been commenced.” 11 U.S.C. §101(13). A person may be a debtor in a Chapter 7 bankruptcy if the person is not a railroad, a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, small business investment company, credit union, or industrial bank. 11 U.S.C. § 109(b). Rig 101 is a limited partnership established for the purpose of providing a rig for drilling services. Rig 101 is not precluded from being a debtor in a Chapter 7 bankruptcy.

Next, the court must determine how many creditors a debtor has and if the creditors are qualified. If a debtor has more than 12 creditors, three are required to file an involuntary petition. In this case, the bankruptcy court found, by the evidence presented, that Rig 101 had more than 12 creditors. “The evidence does seem clear . . . that there were more than 12 creditors of the debtor.” *See May 23, 2007, Transcript (“Tr.”)* at 16, *ll. 9-10, in Appx. Vol. 3* at 726. Reviewing the list of petitioning creditors and taking into consideration the funds that were paid on behalf of Rig 101 by its related entities, it is obvious that the bankruptcy court did not err in this conclusion.

Although it was highly controverted during the hearing, the bankruptcy court next concluded that the last six creditors joined as petitioning creditors were qualified creditors of the Debtor. *See Tr. at 11, ll. 9-18, in Appx. Vol. 3* at 721.

Rig 101 presented argument and testimony that its general partner, Red Rock Drilling, and other related entities were responsible for debts allegedly owed by Rig 101. Rig 101 argued that it was not liable for these debts as the invoices were addressed to the general partner or a related entity or purchased by individuals working for the general partner or related entity. Rig 101 did not dispute that the items ordered were used for Rig 101 or that the representatives ordering the supplies had authority to make these purchases on Rig 101's behalf. The bankruptcy court determined that the purchasers were interrelated between the entities, and that any confusion on the part of the creditors as to whom the debts were to be attributed was caused by the melding of these partnerships and related entities that blurred the lines of communication and business organization. The bankruptcy court determined that the debts were incurred by and for the use of Rig 101 or connected to it. The bankruptcy court, after hearing the testimony and reviewing the evidence presented, determined that those individuals who placed the orders had authority to do so on behalf of Rig 101 and that Rig 101 was responsible for the debts. *See Tr.* at 12, *ll.* 21-24, *in Appx.* Vol. 3 at 722. Specifically, the bankruptcy court determined that Boomer Mud Pump & Supply ("Boomer"), THI Wirerope ("THI"), Gainesville Fuel ("Gainesville"), Woodward Regional Hospital ("Woodward"), Zee Medical ("Zee"), and Tri-State Machine ("Tri-State") were creditors of the Debtor.

The bankruptcy court also determined, after hearing the testimony of the witnesses and reviewing the invoices presented as evidence, that the six creditors had an aggregate claim greater than \$12,300 that was not in dispute. The claims included: Boomer, \$33.76; Gainesville, \$7,271.64; THI, \$18,125.69; Tri-State, \$7,565.49; Woodward, \$343.00; and Zee, \$2,244.40, for a total due, as of the date that the petition was filed, of \$35,583.98. *See Summary of Claims, in Appx.* Vol. 3 at 653. The Debtor did not present evidence refuting the amounts of the claims.

The bankruptcy court concluded that Rig 101 had more than 12 creditors

and that six of the creditors' debts were not subject to a bona fide dispute. The six qualified creditors had an aggregate claim of more than \$12,300. This is three more qualified petitioning creditors than required by the Bankruptcy Code. 11 U.S.C. 303(b)(1). Therefore, the petitioning creditors, Boomer, THI, Gainsville, Woodward, Zee and Tri-State, were qualified to commence the involuntary Chapter 7 bankruptcy petition.

The last factor in determining that the Chapter 7 involuntary petition was properly commenced was whether the debtor was paying its debts as they became due. The court's findings included: (1) Rig 101 only had \$822 on deposit at the bank on the date the petition was filed; (2) Rig 101 did not have any revenue producing assets; (3) Rig 101 owed \$35,583.98 to the six qualified petitioning creditors; (4) Rig 101 owed almost \$3.2 million to its related entities; (5) Rig 101's co-founder admitted that it was bankrupt if it did not receive funding from its general partners and related entities; and (6) Rig 101's related entities were paying its bills. The Court also considered the evidence presented from Rig 101's CFO, Bruce Strawn, of an e-mail to Unibridge, dated December 20, 2006, stating that the Debtor was "out of money." *See Tr.* at 17, *l.* 22, *in Appx.* Vol. 3 at 727.

Rig 101 argued that the only debt it owed was the disputed debt with Unibridge. Rig 101 also argued that the court did not take into consideration that the Debtor was a start-up company and had focused solely on the balance sheet of Rig 101, ignoring that the underlying two-party controversy between the Debtor and Unibridge was the purpose for the commencement of the involuntary bankruptcy. The bankruptcy court, taking into consideration the totality of the circumstances, concluded that Rig 101 was generally not paying its debts as they became due.

The bankruptcy court's findings are supported by and related to the evidence and testimony presented by the parties. Giving the bankruptcy court due regard for presiding at a three day hearing, hearing the testimony, reviewing the

evidence, and judging the credibility of the witness, this Court cannot conclude that the bankruptcy court's findings are clearly erroneous. There is sufficient evidence to support the bankruptcy court's conclusion that three, or in this case six, of the petitioning creditors were qualified to commence the involuntary bankruptcy. There is sufficient evidence to support the court's conclusions that the Debtor was not paying its debts as they became due. There is also sufficient evidence to support the bankruptcy court's conclusions that the debts due on the date the petition was filed were not subject to a bona fide dispute as to amount or liability.

The court concluded that the involuntary Chapter 7 bankruptcy was properly commenced pursuant to 11 U.S.C. § 303 (b) and (h). The bankruptcy court's order for relief under Chapter 7 was not in error.

Rig 101 presented an argument that the bankruptcy court erred when it did not dismiss or abstain pursuant to 11 U.S.C. § 303. This issue was not raised at the trial, was not part of Rig 101's notice of appeal, and will not be considered for the first time on appeal. *Amer. Exch. Bank and Trust Co. v. Wash. Institute for Graduate Studies, (In re Sweatte)*, 76 B.R. 822, 826 (W.D. Okla. 1987) (citing *Burns v. Birmingham Trust Nat'l Bank (In re Gardner)*, 455 F. Supp. 327, 329 (N.D. Ala. 1978)).

Conclusion

The involuntary Chapter 7 bankruptcy was properly commenced. The order for relief under Chapter 7 is affirmed.